

Appeal of Cali-Clubs, Inc.

The sole issue presented by this **appeal is** whether payments in the total amount of \$30,800; made by appellant to its four officer-shareholders during the income year ended March 31, 1974, are deductible as reasonable compensation pursuant to section 24343 of the Revenue and Taxation Code.

Appellant was incorporated in California during 1970 for the principal purpose of operating a nightclub. Each of appellant's four officer-shareholders, Messrs. Schmidt, Mendenhall, Lackey, and Squadrito, owns twenty-five percent of appellant's stock. Appellant employs Mr. Squadrito as a full-time bartender and Mr. Mendenhall as a part-time bartender.

During the income years ended March 31, 1973, 1974, and 1975, appellant paid its four officer-shareholders the following salaries:

<u>Year Ended</u>	<u>Schmidt</u>	<u>Mendenhall</u>	<u>Lackey</u>	<u>Squadrito</u>
3/31/73	\$1,500	\$3,670	\$3,660	\$13,840
3/31/74	-0-	3,640	1,560	13,040
3/31/75	-0-	2,360	1,560	10,445

During the income year ended March 31, 1974, appellant paid the officer-shareholders a total of \$30,800 in addition to the salaries indicated above for that year. The additional payments occurred as follows:

<u>Amount</u>	<u>Time of Payment</u>
\$1,509 each	April-October, 1973
\$2,000 each	November, 1973
\$4,200 each	March, 1974

In its initial franchise tax return for the income year ended March 31, 1974, appellant reported net income of \$31,233 and designated the \$30,800 paid to its officer-shareholders as shareholder dividends. Subsequently, appellant filed an amended return showing net income of only \$433 and a deduction in the amount of \$30,800 for bonus compensation paid to its officers. Respondent disallowed the deduction on the ground that the \$30,800 represented nondeductible dividend payments to appellant's shareholders.

Section 24343 of the Revenue and Taxation Code provides, in pertinent part:

(a) There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the income year in carrying on any trade or business, including--

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(1) A reasonable allowance for salaries or other compensation for personal **services** actually rendered: ...

The burden of proving the extent to which purported salary payments constitute reasonable compensation for personal services actually rendered rests with the taxpayer. (Botany Worsted Mills v. United States, 278 U.S. 282, 289 [73 L. Ed. 379] (1929); Northlich, Stolley, Inc. v. United States, 368 F.2d 272, 277 (Ct. Cl. 1966); Appeal of Welco Wood Products, Inc., Cal. St. Bd. of Equal., May 4, 1976.) With respect to the instant appeal, we note that the record contains only a very general description of the nature and extent of the services rendered by appellant's officers during the income year in question. Appellant's president, Mr. Schmidt, stated that the officers held weekly "director meetings" to plan and manage appellant's business and that the officers had agreed to receive \$20,000 each per year for their participation in the management sessions. However, appellant has failed to submit any concrete evidence, such as minutes of the "director meetings" or other **corporate** records, to establish a direct relationship between the bonus payments and services actually rendered by its officers. Thus, on the basis of the record before us, we conclude that appellant has failed to prove that the payments constituted reasonable compensation for personal services actually rendered.

It should also be noted that the record on appeal contains considerable evidence supporting respondent's conclusion that the bonus payments represented nondeductible dividends. For example, the record indicates that appellant has not formally declared a dividend since its formation in 1970. The record also indicates that the bonus payments were distributed in exact proportion to each officer's stock interest in appellant and that the total payments almost equaled appellant's net income for the year in question. Moreover, the reported salaries paid to appellant's officers during the income year in question, excluding the bonus payments, are nearly identical to the salaries reported for the previous income year. These factors provide ample support for respondent's characterization of the bonus payments as nondeductible dividends. (See Charles McCandless Tile Service v. United States, 422 F.2d 1336, 1339 (Ct. Cl. 1970); Northlich, Stolley, Inc. v. United States, supra, 368 F.2d at 278; R. J. Reynolds Tobacco Co. v. United States, 149 F. Supp. 889, 895 (Ct. Cl. 1957), cert. den., 355 U.S. 893 [2 L. Ed. 2d 1911 (1957)]; Robert Sanders, et al., 1173,075 P-H Memo. T.C. (1973); Nor-Cal Adjusters, 71-200 P-H Memo. T.C. (1971), affd., 503 F.2d 359 (9th Cir. 1974).

For the reasons stated above, it is our opinion that respondent's action in this matter must be sustained.

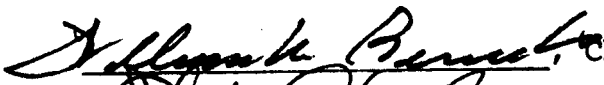
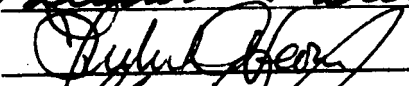
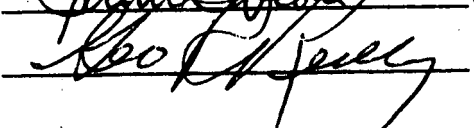
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O R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 26077 of the Revenue and Taxation Code, that the action of the Franchise Tax Board in denying the claim of **Cali-Clubs, Inc.**, for refund of franchise tax in the amount of **\$2,502.00** for the income year ended March 31, 1974, be and the same is hereby sustained.

Done at Sacramento, California, this 8th day of February, 1979, by the State Board of Equalization.

 Chairman
 Member
 Member
_____, Member
_____, Member